BEST AVAILABLE COPY

QUESTIONS PRESENTED

The Federal Arbitration Act of 1925 provides for the enforceability in certain circumstances of arbitration agreements contained in "*a contract evidencing a transaction involving commerce*." 9 U.S.C. § 2. The state court below and numerous other courts construe the Act to apply only where the parties contemplate, at the time of contracting, engaging in substantial interstate activity in carrying out the terms of the contract — so that the contract *itself* "evidenc[es]" an interstate commercial transaction. Three questions are presented here:

1. Should this Court overrule its holding that the Federal Arbitration Act governs proceedings in state courts — a holding announced without the benefit of briefing and without notice to the States, in *Southland Corporation v. Keating*, 465 U.S. 1, 12-16 (1984)?

2. Does § 2's "contract evidencing" language require a court to determine whether the terms of the contract, as well as other objective indicia of its meaning, show that in making the contract the parties contemplated engaging in "a transaction involving commerce"?

3. Does § 2's "transaction involving commerce" language require a court to determine whether the transaction at issue is actually a part of the "current" or "flow" of interstate commerce?

TABLE OF CONTENTS

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iv

STATEMENT OF CASE 1
1. The Contract 1
2. The Dispute 4

SUMMARY OF ARGUMENT 9

ARGUMENT 12

I. THIS COURT SHOULD GRANT THE REQUEST OF THE *AMICI* STATES FOR A HOLDING THAT THE FEDERAL ARBITRATION ACT DOES NOT GOVERN PROCEEDINGS IN STATE COURT 12

II. SECTION 2's "CONTRACT EVIDENCING" LANGUAGE PLAINLY REQUIRES A COURT TO DETERMINE BASED ON THE CONTRACT BETWEEN THE PARTIES WHETHER THEY CONTEMPLATED ENGAGING IN "A TRANSACTION INVOLVING COMMERCE" 15

III. SECTION 2's "A TRANSACTION INVOLVING COMMERCE" LANGUAGE PLAINLY REQUIRES A COURT TO DETERMINE WHETHER THE TRANSACTION AT ISSUE IS ACTUALLY PART OF THE "CURRENT" OR "FLOW" OF INTERSTATE COMMERCE 23

CONCLUSION 28

TABLE OF AUTHORITIES

Cases: **Page**

Bernhardt v. Polygraphic Co. of America, 350 U.S. 198 (1956) . . . . . *passim*
Binderup v. Pathe Exchange, Inc., 263 U.S. 291 (1923) 23
Cherry, Bekaert & Holland v. J. Charles Brown, 582 So.2d 502 (Ala. 1991) 3
Cincinnati, Portsmouth, Big Sandy and Pomeroy Packet Co. v. Bay, 200 U.S. 179 (1906) 22
Continental Grain Co. v. Beasley, 628 So.2d 319 (Ala. 1993) 8
Embrey v. Southern Gas & Electric Corp., 63 So.2d 258 (1953) 20
Ex Parte Jones, 628 So.2d 316 (Ala. 1993) 8
Farnsworth v. Duffner, 142 U.S. 43 (1891) 20
Federal Trade Comm'n v. Bunte Bros., 312 U.S. 349 (1941) 25
Gregory v. Ashcroft, 111 S. Ct. 2395 (1991) 10
Gulf Oil Corp. v. Copp Paving Co., 419 U.S. 186 (1974) 25
Hawaiian Airlines, Inc. v. Norris, 62 U.S.L.W. 4537 (U.S. June 20, 1994) 25
Hooper v. California, 155 U.S. 648 (1895) 27
Kansas City Structural Steel Company v. Arkansas, 269 U.S. 148 (1925) 23
Keating v. Superior Court, 31 Cal.3d 584, 645 P.2d 1192, 183 Cal. Rptr. 360 (1982) 13
Metro Indus. Painting Corp. v. Terminal Const. Co., 287 F.2d 382 (2d Cir.), *cert. denied*, 368 U.S. 817 (1961) 7, 10, 15
Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) 13
New York v. United States, 112 S. Ct. 2408 (1992) 10
New York Life Ins. Co. v. Deer Lodge County, 231 U.S. 495 (1913) 27
Perry v. Thomas, 482 U.S. 483 (1989) 11, 21, 24

TABLE OF AUTHORITIES (Cont.)

Cases: **Page**

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) . . . . . *passim*
Rodriguez de Quijas v. Shearson/ American Express, Inc., 490 U.S. 477 (1989) 21
Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987) 21
Southland Corp. v. Keating, 465 U.S. 1 (1984) . . . . . *passim*
Summit Health, Ltd. v. Pinhas, 111 S. Ct. 1842 (1991) 28
United Leather Workers v. Herkert, 265 U.S. 457 (1925) 26
United Mine Workers v. Coronado Coal Co., 259 U.S. 344 (1922) 26
Volt Information Sciences v. Board of ustees of Leland Stanford Jr. Univ., 489 U.S. 468 (1989) . . . *passim*
Ware and Leland v. Mobile County, 209 U.S. 405 (1908) 27
Wells v. Mobile County Board of Realtors, Inc., 387 So.2d 140 (Ala. 1980) 4
Will v. Michigan Dept. of State Police, 491 U.S. 58 (1989) 10

Constitutional Provisions, Statutes and Rules:

9 U.S.C. §§ 1, et seq. 1
9 U.S.C. § 2 . . . . . *passim*
9 U.S.C. § 3 14
9 U.S.C. § 4 14

Miscellaneous:

Black's Law Dictionary (2d ed. 1910) 19
2 Bouvier's Law Dictionary (rev. ed. 1897) (ed. F. Rawle) 19

BRIEF OF RESPONDENT

STATEMENT OF THE CASE

This case involves application of the Federal Arbitration Act (the "FAA" or "the Act"), 9 U.S.C. §§ 1 et seq., to a lawsuit in the Alabama state courts arising from termite inspection and extermination services provided to Alabama homeowners by service personnel who are trained, licensed, based and supervised entirely in Alabama.

1. The Contract.

The contract in question, a "Termite Protection Plan," J.A. 75,[1] or "termite bond," Pet. App. 1a; Rec. 1579, was entered into by respondents herein, G. Michael Dobson and Wanda C. Dobson, on May 10, 1991. On that date, the Dobsons purchased a home in Fairhope, Alabama, from respondents Steven and Jan Gwin.[2] At the closing, the Gwins assigned over to the Dobsons their existing termite bond, as they had earlier agreed upon, J.A. 66 ¶ 16, and as expressly authorized by the termite bond itself.[3]

---

[1] Citations to the Joint Appendix will be styled "J.A. ___." Citations to the Appendix to the Petition for Certiorari will be styled "Pet. App. ___a." Citations to the Brief of the Petitioner will be styled "Pet. Br. ___." Citations to the record in the Supreme Court of Alabama below will be styled "Rec."

[2] Although respondents in this Court, the Gwins did not actively participate in the Alabama courts below on the issue of the arbitrability of the dispute, nor did they file a brief at the certiorari stage.

[3] The plan, which the Gwins had purchased four years earlier for $585.87 plus a $65.87 annual "extension charge" for the lifetime of the property, provided in relevant part:

> Upon transfer of ownership of the identified property, protection against subterranean termites may be continued upon the request of the new owner and upon payment of a contract transfer fee of $25.00. In addition, Terminix reserves the right to revise the annual extension charge upon transfer of ownership. In the event the new owner fails to request continued coverage or does not agree to pay the transfer fee or the revised annual extension charge, the Termite Protection Plan will terminate automatically as of the date of this change of ownership.

J.A. 75 (fifth paragraph).

"[I]t was explained to [the Dobsons] that there was an existing termite bond on the property that was being transferred," J.A. 63, although the Dobsons did not receive a copy of the termite bond they were being assigned. Rec. 991, 1014.

The termite bond assigned to the Dobsons had been purchased by the Gwins in 1987 from petitioner Allied-Bruce Terminix Companies, Inc. (trading as "Terminix Service"), through its nearby office in Daphne, Alabama. J.A. 75. Terminix Service is a franchisee of petitioner Terminix International Company ("Terminix International"), which provides the training, organizational and advertising support of the typical franchise operator, in exchange for a share of franchisee revenue. Rec. 106, 114, 1673, 1688-93. Although Terminix International insures customers against potential default on the service obligations of its franchisees, Rec. 1699,[4] according to Terminix Service employees, customers are made aware that they are "dealing with someone other than Terminix International," that "they are just dealing with us as local companies." *Id.*; *see also* 1476 (a local employee is "strictly an employee of Terminix Service").[5]

Prior to taking assignment of the termite bond at the closing on May 10, 1991, the Dobsons had "no conversations with anyone with either of those companies," Rec. 480; *see also* Rec. 445, 1646. The bargain reflected in the written contract

---

[4] Terminix International also performs a background insurance function for its franchisees, helping them spread the costs of expensive treatment problems. Terminix International reimburses its franchisees for 80 percent of costs for repairing termite damage, after payment of an $1100 deductible per occurrence. Rec. 1694-96, 1698; *see also* Rec. 1476 (Terminix International "is like an insurance company").

[5] Consistent with this local focus, the manager of the Daphne office, his supervisor, and the vice president overseeing Alabama operations, are all located in Alabama, Rec. 1683-87, with the main office located in nearby Mobile. Rec. 1715. Employees of the Daphne branch are trained in the Mobile office. Rec. 1472, 1687. The branch's operations are licensed in Alabama and closely supervised by state regulators. Rec. 1604, 1727-33.

was straightforward: in exchange for an "annual extension charge" of $65.87 to be paid by the assignee (the amount of which might be revised), Terminix would provide termite protection for the lifetime of the residence located at 114 Fels Avenue in Fairhope, Alabama. J.A. 77. Specifically, Terminix promised to "provide the necessary service to protect the identified property against the attack of subterranean termites." J.A. 77 (first paragraph).[6]

Among the general conditions listed on the back of the form contract is an arbitration clause, stating in principal part: "The Purchaser and Terminix agree that any controversy or claim between them arising out of any provision of this agreement shall be settled exclusively by arbitration." J.A. 78 (¶ 9); *see also* Pet. Br. at 4 n.3 (full text).

Although the contract recites that "Terminix performs its services in accordance with the requirements of federal, state and local law," J.A. 78 (¶ 6), the contract is silent on the issue of what jurisdiction's law applies in determining the meaning and validity of the contract's provisions, including the arbitration clause. When the Dobsons entered into the contract in 1991, it was well settled under Alabama law that "a contract is governed by the laws of the state where it is made except where the parties have legally contracted with reference to the laws of another jurisdiction." *Cherry, Bekaert & Holland v. J. Charles Brown*, 582 So.2d 502, 506 (Ala. 1991). It was equally well settled that

---

[6] The contract elaborates: "After this Plan is renewed beyond the initial contract term, Terminix will periodically reinspect the identified property and any further treatment found necessary will be performed free." J.A. 77 (second paragraph). The nature and limits of the covered services are defined more precisely as follows: "This Plan provides protection against new subterranean termite damage to the structure and contents. If new damage occurs during the contract term, Terminix will, upon notification and inspection, arrange for the necessary repairs and pay the cost of labor and materials not to exceed $100,000. New damage is damage associated with an active termite infestation. Unless live termites are found in the damaged area, the damage discovered is old damage and not covered under this Plan." J.A. 77 (fourth paragraph). In addition, various other "general conditions" are elaborated on the back of the form contract. J.A. 78.

"[t]he public policy of [Alabama] is to encourage arbitration and amicable settlements of disputes between parties; but public policy also holds void an agreement in advance to oust or defeat the jurisdiction of all courts, as to all differences between parties." *Wells v. Mobile County Board of Realtors, Inc.*, 387 So.2d 140, 144 (Ala. 1980). Nothing in the form contract that was assigned to the Dobsons purported to displace this rule. There was no indication that the Federal Arbitration Act might control the validity of the arbitration clause, nor any indication that the performance of the contract would involve interstate commerce in any way.

2. The Dispute.

The dispute between the parties began not with the termite bond assigned to the Dobsons, but with a report issued by Terminix to the Gwins three days before closing, on May 7, 1991, certifying that "[n]o visible evidence of infestation from wood destroying insects was observed." J.A. 5 (box 8(b)). This report was a service provided to the Gwins, who needed it to fulfill their sales contract, which required "a bonded and licensed termite control company" to certify "that a visual inspection by them indicates the dwelling is free from infestation by wood destroying insects." J.A. 66 (¶ 16). As the responsible Terminix Service vice president testified, this type of report — done to assess the condition of a residence for sale, not as part of termite eradication efforts — "doesn't have anything to do with the termite protection plan. It stands alone." Rec. 1780.

The report was issued by the head of the Daphne branch of Terminix Service. He admitted that when he did the inspection and issued the report he knew that he was doing it for the Dobsons' benefit and that the buyer "would be most interested in knowing if there are termites in the property." Rec. 1558-A. The Dobsons in fact relied on the report in proceeding with the closing. Rec. 451-52, 880-82.

One week after the closing, as they began preparations to move in within two weeks, the Dobsons discovered that the report was wrong, "[t]he whole thing [was] false," because the entire home was "absolutely infested with live termites." Rec.

888. In doing minor work on wall paneling, and then making more extensive checks, they discovered that there were "live termites swarming everywhere," Rec. 477, 998. Called in to inspect the house and begin extermination efforts that were to span months, the head of the Daphne office of Terminix Service said that the Dobsons "probably won't ever see this many termites again in one place." Rec. 498. Another Terminix Service employee admitted it was "a terrible problem." Rec. 1424. The Gwins' realtor agreed that the house was "totally and completely infested with live termites." Rec. 1235.

The Dobsons were shocked that their house was termite-ridden just days after professionals at Terminix had certified that there was no visible evidence of live termites. They investigated and learned that just six weeks before certifying the house as termite-free, Terminix employees had been at the house attempting to exterminate a massive swarm of termites. Rec. 1523-44, 1614-22, 1767. None of this had been revealed by Terminix. Even more seriously, the Dobsons discovered evidence that Terminix had affirmatively covered up its knowledge of signs of termite infestation that were in plain view on May 7, 1991, when Terminix issued its report.[7] Further, the Dobsons believed that the Gwins had also misled them about the house by failing to reveal the recent termite damage and the extensive eradication efforts. Rec. 583, 590, 1234.

Because Terminix and the Gwins had concealed their knowledge of the termite infestation, the Dobsons were led into buying a house that required immediate, massive termite eradication efforts, imposing serious financial and personal strain

---

[7] Someone who had heard Terminix employees working on the house told Mr. Dobson that he would be "real surprised" at what he would find if he crawled under the house. Rec. 889, 1045. Mr. Dobson discovered that it was "clearly eaten up with live termites, from a "view that the Terminix inspector would have had to see," although that inspector had nonetheless marked on the report that underneath the house there was only "*old* termite damage with no live infestations." Rec. 889 (emphasis added); 1548. Not only was this damage plainly visible but, based on what the witness had seen and overheard, the Terminix employees had actually seen the problem but had failed to disclose it.

for many months.[8] On October 15, 1991, five months after this ordeal began, the Dobsons filed tort claims in Alabama state court against the Terminix companies and the Gwins. J.A. 7-10. In relevant part the Dobsons alleged that the Terminix companies had falsely and fraudulently "represented to the Plaintiffs that there was no visible evidence of infestation from wood destroying insects," J.A. 8, or, if they somehow lacked actual knowledge of the termites, that their inspection had been performed negligently. J.A. 9.

The defendants answered the complaint, and discovery and pretrial proceedings began. Eight months later, following inadequate repair efforts by Terminix under the termite bond and particularly a failure to cover all necessary repair-related costs, the Dobsons amended their complaint to allege breach of the termite bond.[9] A few days later, the Gwins filed a similar cross-claim against the Terminix companies. J.A. 55-57.

---

[8] Because the termite treatments involved effectively tearing apart, treating and then rebuilding the entire inside of the house, the Dobsons were unable to unpack for eight to nine months until early 1992, going "from living on a mattress on the floor in the bedroom to having all the walls ripped out and living on a mattress on a floor in another bedroom with boxes all around us." Rec. 1047-48. The Dobsons' home was infamous in the small town to which they had just moved, becoming known as "the termite pit or the termite house" and, eventually, "the Money Pit," with people stopping by to say, "we heard about this, we know about you, we know what's going on." Rec. 579-81. The Dobsons were "humiliated, embarrassed, stressed, financially strapped," and "forced to live like pack rats for the majority of this time." Rec. 1047.

[9] Paragraph 6 of Count Four of the First Amended Complaint, filed June 25, 1992, alleges:

> That the Defendants, Terminix, have breached the terms of said Termite Protection Plan by failing to protect the identified property against the attack of subterranean termites, in that said dwelling has, since the purchase by the Plaintiffs, been infested throughout with live termites; and in that said Defendants, Terminix, did not arrange for all of the repairs rendered necessary by or pay for the same, but rather that the Plaintiffs were required to arrange for and pay for many of said repairs.

J.A. 53.

At this point, the Terminix companies invoked the Federal Arbitration Act, moving for an order compelling arbitration and for a stay of all litigation pending arbitration. The Terminix companies argued that the termite bond constituted the basis of all the claims asserted against them, J.A. 82-83, and that the termite bond was "a contract evidencing a transaction involving commerce" within the meaning of § 2 of the Act. J.A. 83-88.

In an effort to meet the statutory test, Terminix Service included an affidavit from its vice president in Mobile, Alabama, stating that Terminix Service was an Arkansas corporation and, further, that "[m]ost of the materials and equipment including specifically the chemical used to treat the home involved in this suit" had travelled from out of state before being used on the home. J.A. 72; *see also* J.A. 86. For its part, Terminix International rested on an officer's affidavit that it was incorporated in "a State other than Alabama" and operated elsewhere. J.A. 79-80; *see also* J.A. 86. Terminix International did not assert that it had engaged in *any* interstate activity in performing the termite bond; indeed, earlier it had stated that it had "no knowledge" of the Dobsons' situation. Rec. 116.

The Dobsons opposed application of the Act, arguing that "these connections with interstate commerce are too tenuous" to justify preemption of state law concerning a "purely local transaction" involving a home purchase between Alabama residents with an incidental assignment of a locally supervised termite bond. J.A. 93. Citing the Alabama Supreme Court's earlier reliance on *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 387 (2d Cir.), *cert. denied*, 368 U.S. 817 (1961) (Lumbard, C.J., concurring), the Dobsons urged that a focus on the "contemplation of the parties" was necessary. J.A. 93-95. Contrasting this case to one in which the contract "specifically called for" substantial interstate activity, J.A. 94, the Dobsons pointed out that they had "involved themselves in a routine consumer transaction with no notion whatever that they might be involved in interstate commerce," given that "[t]he Terminix [Service] office was in Daphne and there was no hint of any interstate activity." J.A. 95. The Terminix companies' attempt to force arbitration was denied. J.A. 96.

The Alabama Supreme Court granted discretionary review to consider the Terminix companies' claim that they had been improperly denied the benefit of § 2. The companies advanced the argument that, under § 2 of the Act, a "contract evidenc[es] a transaction involving commerce" whenever "that contract relates to or affects interstate commerce in any way," regardless of how the parties understood the transaction when they formed the contract. Brief of Appellants, at 19. Despite the meager interstate contacts laid out in their affidavits, the Terminix companies argued that "a party being from another state" or "purchase and transportation of materials from another state" was as a matter of law sufficient to trigger § 2's preemptive effect on state arbitration policy. *Id.*

The Dobsons urged that § 2 was not met because "there is no reason to believe that *at the time of contracting*, the parties to this consumer transaction contemplated any interstate activity" and that "[i]t is difficult to imagine a more 'local' transaction than employing someone to treat insects in one's home." Brief of Appellees at 13 (emphasis added). Focusing on what was "evidence[d]" by the contract, the Dobsons argued that it was irrelevant "that *it turns out* that the termite company which did the inspection had offices in states other than Alabama where one part of the form contract was executed and, at some point in the past, applied chemicals around the house which were purchased outside the state." *Id.* at 11 (emphasis added).

The Alabama Supreme Court rejected the Terminix companies' expansive view of the preemptive effect of § 2, reaffirming a pair of decisions in which it had embraced the "contemplation of the parties" test as more faithful to the text and purpose of the Act. *See* Pet. App. at 3a & n.1. In *Ex Parte Jones*, 628 So.2d 316 (Ala. 1993), the court had stressed that the plain language of § 2 requires that "*the agreement* that contains the pre-dispute arbitration provision must involve interstate commerce," finding in that agreement "no reference to any interstate matters." *Id.* at 317 (emphasis in original). In *Continental Grain Co. v. Beasley*, 628 So.2d 319 (Ala. 1993), however, the court made clear the evenhanded nature of this test, ruling that contracts "performed entirely within Alabama" will

nonetheless trigger § 2 if "[i]n performing their contractual obligations, the plaintiffs were directly engaging in the production of articles to be shipped in interstate commerce." *Id.* at 323.

Reviewing the record concerning whether the agreement between the parties involved interstate commerce, the court below found that "the evidence adduced by the Terminix companies does not establish that the parties contemplated substantial interstate activity when they entered the termite bond." Pet. App. 6a. The court rejected the idea that it could be enough under § 2 of the FAA "to show that one or more of the parties to the contract is located in another state," *id.*, focusing instead on what the parties contemplated in their agreement about "the *performance* of the bond obligations." *Id.* at 7a (emphasis in original). The fact that, as it turned out, "some materials used in fulfilling the bond obligations may have come from out-of-state suppliers" did not reasonably suggest, the court reasoned, that the parties "contemplate[ed] substantial interstate activity when they entered into the contract." *Id.* Therefore, the court held, the termite bond to which the Dobsons were a party was not "a contract evidencing a transaction involving commerce" within the meaning of § 2.

SUMMARY OF ARGUMENT

Section 2 of the Federal Arbitration Act of 1925 governs arbitration agreements in "contract[s] evidencing a transaction involving interstate commerce." 9 U.S.C. § 2. The Alabama Supreme Court correctly held that the Act does not apply to a termite bond purchased by Alabama homeowners from an Alabama termite services company.

I. This case arose in Alabama state court, not in federal court. As the Attorneys General of Alabama and 19 other States demonstrate in a brief *amici curiae* supporting respondents, the FAA should not be interpreted as governing proceedings in state court. This Court should overrule the decision in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), to the extent that it held to the contrary and should adopt the construction of the FAA out-

lined in the dissenting opinion of Justice O'Connor in *Southland*, in which the current Chief Justice joined. The *Southland* Court was denied the benefit of full adversarial briefing and argument on the issue of whether the Act governs proceedings in state courts, primarily because in the California courts the *Southland* appellees had erroneously assumed that the Act applied. The States were not put on notice that the issue was before this Court and accordingly did not have a chance to participate.

The question is again presented, this time in more suitable fashion. The States persuasively demonstrate that the FAA does not contain the requisite "clear congressional statement" that would be necessary to justify the intrusion into state sovereignty and matters of traditional state concern, in light of this Court's recent decisions emphasizing the importance of federalism. *See New York v. United States*, 112 S. Ct. 2408 (1992), *Gregory v. Ashcroft*, 111 S. Ct. 2395 (1991), and *Will v. Michigan Dept. of State Police*, 491 U.S. 58 (1989). In adopting the FAA, Congress was repeatedly assured that the statute would *not* apply in state court, and lower courts and commentators unanimously adhered to that view for decades after the Act's enactment. The factors that normally lead this Court to decline to revisit issues of statutory construction are not present here. Indeed, this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), has already undermined the assumptions on which *Southland* was based.

II. Even if *Southland* were not overruled, the judgment below would still have to be affirmed, for even if the case below had arisen in federal court it would not be within the scope of the FAA. The termite bond at issue is not "a contract evidencing a transaction involving [interstate or foreign] commerce," within the meaning of § 2 of the FAA, 9 U.S.C. § 2.

The "contemplation of the parties" test developed by Chief Judge Lumbard in *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 387 (2d Cir.) (concurring opinion), *cert. denied*, 368 U.S. 817 (1961), best effectuates the statutory language and Congress' intent. Judge Lumbard's approach focuses on the *full* description of the type of contract to which

§ 2 refers: "a contract evidencing a transaction involving commerce." It is the *contract* which must evidence a transaction involving commerce. Accordingly, the appropriate question is whether, *at the time the contract was made*, reasonable persons in the parties' position would have contemplated more than *de minimis* interstate activity in carrying out the terms of the contract. The statutory test is not, as petitioners would have it, simply whether the parties' conduct *turns out* to "involve" or "affect" interstate commerce one way or another, even if such connections to commerce were wholly fortuitous or unforeseeable at the time of contracting.

The "contemplation of the parties" test, which has been used by many courts since it was developed over thirty years ago, is more faithful to the statutory language than is petitioners' proposal. The contemplation test recognizes that the key phrase — "a contract evidencing a transaction involving commerce" — is a single unit which must be construed as a whole. This Court has shared this view in *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198, 200 (1956), and more recently in *Perry v. Thomas*, 482 U.S. 483, 490 (1989), where this Court explained that § 2 applies only to "a contract evidencing interstate commerce." This Court's recognition that it is the *contract*, not the *transaction*, which must "evidence interstate commerce" strongly supports the "contemplation of the parties" test and undermines petitioners' novel proposal.

Indeed, petitioners' argument would require this Court to overrule the interpretation of § 2 set forth in *Bernhardt* and never doubted since. *Bernhardt* held that the Act did not apply to an employment contract made by parties residing in New York, even though it provided for one of the parties to change his state of residence and perform his employment obligations in the new state. Petitioners' view of § 2 of the FAA is squarely foreclosed by the holding of *Bernhardt*.

The "contemplation of the parties" test provides a workable approach that permits parties that are plainly engaged in interstate commerce to invoke the provisions of the FAA, while ensuring that unsuspecting consumers and other unsophisticated parties do not find themselves bound by the Act. The test thus honors the

reasonable expectations of the parties, which this Court identified as a key objective of the FAA in *Volt Information Sciences*. Petitioners' approach would defeat the reasonable expectations of the parties, by sweeping into the ambit of the FAA contracts whose parties did not expect to be subject to the jurisdiction of the Act.

Moreover, the "contemplation of the parties" test is consistent with Congress' understanding of Commerce Clause jurisprudence in 1925. Congress was on notice that, in construing statutes regulating contractual relationships, the courts would look to the contemplation of the parties to determine the nexus to interstate commerce.

III. Even if the "contemplation of the parties" test were rejected and petitioners' proposal adopted, the judgment below would still have to be affirmed. It is highly significant that § 2 of the FAA uses the phrase "involving commerce" rather than "affecting commerce." *Bernhardt* indicates that § 2 does *not* extend to the limits of Congress' power under the Commerce Clause, and that decision is still good law. The FAA was adopted in 1925 against the background understanding that the word "involve" has a much narrower meaning than the word "affect." By using the phrase "involving commerce," Congress meant to include only conduct that is actually within the "current" or "flow" of interstate commerce. The termite bond at issue does not qualify under this test.

ARGUMENT

I. THIS COURT SHOULD GRANT THE REQUEST OF THE *AMICI* STATES FOR A HOLDING THAT THE FEDERAL ARBITRATION ACT DOES NOT GOVERN PROCEEDINGS IN STATE COURT

This case provides a suitable vehicle for this Court to revisit an issue prematurely addressed in *Southland Corporation v. Keating*, 465 U.S. 1 (1984), without the benefit of any briefing or even oral argument: the issue of whether the FAA governs proceedings in state court in the first place. This issue

was never properly joined in *Southland* and therefore should be considered now, based on the Brief *Amici Curiae* of the Attorneys General of Alabama and 19 other States in Support of Respondents ("States' Br."). The States decisively demonstrate the profound flaws in the *Southland* majority opinion of Chief Justice Burger, joined by Justices Brennan, White, Marshall, Blackmun and Powell, and explain why the dissenting opinion in *Southland*, 465 U.S. at 21-36 (O'Connor, J., joined by Rehnquist, now C.J., dissenting), was clearly correct in its reading of the statute.

The factors that normally lead this Court to avoid revisiting issues of statutory construction are not present here, for this case involves fundamental issues of federalism on which the States were not heard in 1984, and on which the controlling jurisprudence has shifted in the past decade.

In *Southland*, the state-court private plaintiffs who appeared as appellees had stipulated in the lower courts that the FAA applies in state court. *See* Brief of Appellees in No. 82-500 (filed June 6, 1983) at 25 n.30; *Keating v. Superior Court*, 31 Cal.3d 584, 604, 645 P.2d 1192, 1203, 183 Cal. Rptr. 360, 371-72 (1982). The appellees sought affirmance of the judgment denying arbitration only on the basis that the FAA did not preempt California's targeted statutory scheme designed to protect franchisee owners. The appellees continued to ignore the issue even after one justice, at the beginning of oral argument, suggested to the appellant that the legislative history on the issue was "pretty clearly against" the idea that the Act applies in state courts, and that the Court's previous comment to the contrary in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 26 n.34 (1983), was clearly dictum as *Moses H. Cone* came from a federal court. Oral Argument Transcript, No. 82-500, Oct. 4, 1983, at 7-8.

In *Southland*, this Court was denied the benefit of adversarial briefing, in particular the benefit of a brief from the States. *See* States' Br. at 1-2 & n.2. Moreover, the approach to statutory interpretation used in *Southland* has been outmoded by key precedents during the past decade. The *Southland* majority

held the FAA to have a massive preemptive effect in all state-court proceedings despite the plain text of the Act addressing only "courts of the United States" (§ 3) and "United States district court[s]" (§ 4), and the admission that "the legislative history is not without its ambiguities." 465 U.S. at 12.

The *Southland* majority's core supposition that "Congress had in mind something more than making arbitration agreements enforceable only in the federal courts," *id.*, obviously cannot survive the scrutiny of this Court's "clear statement" jurisprudence increasingly emphasized subsequent to *Southland*. *See* States' Br. at 8-9. Moreover, the opinion for the Court delivered by the Chief Justice in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 477 (1989), noting that the FAA lacks an "express pre-emptive provision" and does not "reflect a congressional intent to occupy the entire field of arbitration," is in obvious tension with *Southland*. In sum, there are ample reasons for this Court to take this opportunity to overrule the precipitate and ill-advised *Southland* holding that the FAA governs state-court proceedings. That the issue was not litigated and decided below is entirely understandable and of course presents no barrier to this Court's review. *See* States' Br. at 5 n.8.

However, this Court need not revisit the *Southland* issue in order to affirm the judgment of the Alabama Supreme Court because, even if this case had arisen in federal court, the FAA would not apply to the termite bond that was assigned to the Dobsons. For nothing in the text or legislative history of § 2 suggests that the termite bond is "a contract evidencing a transaction involving commerce."

II. SECTION 2's "CONTRACT EVIDENCING" LANGUAGE PLAINLY REQUIRES A COURT TO DETERMINE BASED ON THE CONTRACT BETWEEN THE PARTIES WHETHER THEY CONTEMPLATED ENGAGING IN "A TRANSACTION INVOLVING COMMERCE"

The "contemplation of the parties" standard employed by the court below in analyzing § 2 of the Act has been relied on by many courts[10] and flows naturally from the plain language of § 2, supplemented by a practical understanding of the purposes of the Act. As explained by Judge Lumbard in his influential opinion in *Metro Indus. Painting Corp. v. Terminal Const. Co.*, 287 F.2d 382, 387 (2d Cir.) (Lumbard, C.J., concurring), *cert. denied*, 368 U.S. 817 (1961), such a test is necessitated by Congress's very specific description of the type of contract that falls under § 2's ambit.

Judge Lumbard was careful to focus on the *full* description of the type of contract Congress targeted in § 2: "a contract evidencing a transaction involving commerce." As he pointed out:

> The statute does not purport to affect arbitration provisions in *all* contracts involving commerce; it puts its stamp only on such provisions when incorporated in contracts *evidencing a transaction* involving commerce.

Id. at 387 (first emphasis added). From the "contract evidencing" language selected by Congress, it was obvious to Judge Lumbard that a judge's task is not to look at a transaction between parties retrospectively, asking "what in fact happened." *Id.* Rather, a judge must determine "what was in the contemplation of the parties as manifested in their written agreement." *Id.*

As Judge Lumbard further pointed out, given § 2's rigorous, almost "formalistic" requirement that the contract at

---

[10] *See* Brief *Amicus Curiae* of the Southern Poverty Law Center in Support of Respondents ("So. Poverty Law Ctr. Br."), at 8-9 & n.10 (listing selected cases).

issue "evidenc[e] a transaction involving commerce," in looking only to the words of the statute "we might be justified in limiting the effect of the act to only those contracts which, *on their face*, reveal that some interstate transaction is to take place." *Id.* (emphasis added). Such a close focus on the text of § 2, Judge Lumbard noted, would restrict the preemptive effect of the Act "upon essentially local transactions." *Id.* At the same time, it appears that this narrow reading of § 2 would have fully accomplished the objectives behind the Act held by the merchants who helped draft it and who appeared before Congress in 1925 to lobby for its passage — merchants who dealt with interstate commodities shipments and whose contracts routinely made clear, on their face, the interstate transaction involved.[11]

---

[11] As Justice Black summarized the legislative history several years after Judge Lumbard's opinion, in his dissent to *Prima Paint v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967):

> The principal support for the Act came from trade associations dealing in groceries and other perishables and from commercial and mercantile groups in the major trading centers. Practically all who testified in support of the bill before the Senate subcommittee in 1923 explained that the bill was designed to cover contracts between people in different States who produced, shipped, bought, or sold commodities. The same views were expressed in the 1924 hearings. When Senator Sterling suggested, "What you have in mind is that this proposed legislation relates to contracts arising in interstate commerce," Mr. Bernheimer, a chief exponent of the bill, replied: "Yes; entirely. The farmer who will sell his carload of potatoes, from Wyoming, to a dealer in the State of New Jersey, for instance."

Id. at 409 n.2 (Black, J., dissenting) (citations omitted). *See also* So. Poverty Law Ctr. Br. at 4-5 & n.8. Although the majority in *Prima Paint* did not dispute Justice Black's explication of the genesis of the Act, it rejected Justice Black's argument from that premise that the FAA should "apply only to 'contracts between merchants for the interstate shipment of goods.'" 388 U.S. at 401 n.7 (quoting dissent). But the *Prima Paint* majority did not embrace the present petitioners' reading of § 2 of the FAA. Rather, the majority indicated merely that the Act applied to an agreement between two business corporations concerning "the purchase of an entire interstate paint business and its re-

Judge Lumbard elected to construe § 2 of the Act more broadly than its plain language would perhaps dictate, based on a "more realistic appraisal of the ends Congress wished to serve." 287 F.2d at 387. However, Judge Lumbard was careful to remain faithful to the text of § 2. It was clear to him that "Congress was *not* seeking to regulate and control activity affecting commerce," preempting the field of arbitration with an "intent to affect all contracts possessing certain interstate elements." *Id.* (emphasis added). Rather, Congress "was providing for those engaged in interstate transactions an expeditious extra-judicial process for settling disputes," and "the purpose of the act was to assure those who desired arbitration that their expectations would not be undermined by federal judges." *Id.*

The required focus on the parties' expectations meant, of course, that the ultimate issue under § 2 is the contemplation of the parties. As Judge Lumbard explained:

> The significant question, therefore, is not whether, in carrying out the terms of the contract, the parties *did* cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they *contemplated* substantial interstate activity. Cogent evidence regarding their state of mind at the time would be the terms of the contract, and if it, on its face, evidences interstate traffic . . . the contract should come within § 2. In addition, evidence as to how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated.

Id.[12]

---

establishment and operation in another State." *Id.* at 402 n.7. Such a contract would fall within any conception of the Act's scope.

[12] After articulating this clear and sensible test designed to defend the parties' reasonable expectations, Judge Lumbard found the case before him

Contrary to assertions of petitioners and their *amici*, Judge Lumbard's analysis is not the antiquated relic of a bygone era. Rather, it is a workable standard that has stood the test of time for over 30 years and continues to be used by many courts today. *See* note 10, *supra*. Judge Lumbard's analysis demonstrating that Congress was not seeking to preempt the arbitration field by regulating all contracts affecting commerce matches a similar ruling by this Court five years ago, announced by the Chief Justice in *Volt Information Sciences v. Board of Trustees of Leland Stanford Jr. Univ.*, 489 U.S. 468 (1989), holding that "[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration," *id.* at 477, and that "parties are generally free to structure their arbitration agreements as they see fit." *Id.* at 479. Notably, petitioners have ignored *Volt Information* in all three briefs filed in this Court. Moreover, petitioners ignore that even the majority opinion in *Southland Corp. v. Keating*, 465 U.S. 1, 13 (1984), endorsed Judge Lumbard's view that the Act was designed to protect parties' contractual expectations.

Further, petitioners' entire effort to overturn Judge Lumbard's test rests on a linguistic absurdity. The obvious meaning of the words of § 2, as Judge Lumbard emphasized, is that § 2 does not apply unless the contract at issue "evidenc[es] a transaction involving commerce." The phrase is a single unit which must be construed as a whole. This Court adopted that very construction of § 2 in both of its cases construing the nature of the contracts covered by § 2. In *Bernhardt v. Polygraph Co. of America*, 350 U.S. 198 (1956), this Court made clear that the phrase in question must be read as a unified whole:

---

simple to resolve: the face of the contract at issue showed that two companies doing business in New York entered into a subcontractor agreement on a Florida construction project, and the performance of the contract had involved substantial travel from New York to Florida, so that "it appear[ed] reasonably clear that the parties anticipated substantial interstate traffic." *Id.* at 388.

> Section 2 makes "valid, irrevocable, and enforceable" only two types of contracts: those relating to a maritime transaction and those involving commerce. No maritime transaction is involved here. Nor does this contract *evidence "a transaction involving commerce"* within the meaning of § 2 of the Act.

Id. at 200 (emphasis added). *See also Prima Paint,* 388 U.S. at 401 (reaffirming this aspect of *Bernhardt*).

Despite *Bernhardt*'s straightforward statement that under § 2 the contract must evidence a very particular kind of transaction — "a transaction involving commerce" — petitioners urge a different reading of § 2, a reading that is essential to their effort to dislodge the "contemplation of the parties" test. In petitioners' view, the words "contract evidencing" modify *only* the next two words in § 2, "a transaction." Pet. Br. at 15, 24. Once a judge has consulted the contract long enough to confirm that it evidences "a transaction," we are told, the judge can set the contract aside. The only remaining question is whether the judge can find, somewhere in the record, that some part of the transaction *as ultimately carried out* crossed state lines and thereby supposedly "involv[ed] commerce." What the parties *contemplated* about interstate activity when they made the contract is irrelevant, because under petitioners' proposed construction the contract itself need not evidence "a transaction involving commerce" — just "a transaction." "Taken at face value," petitioners argue, "the contract must be evidence of the *transaction*, not of the 'commerce' to which it applies." Pet. Br. at 15 (emphasis in original). *See also* Pet. Br. at 24 ("the contract must be evidence of the transaction").

The linguistic absurdity that pervades petitioners' entire line of argument is that, by definition, *every* contract evidences a transaction, because every contract *is* a transaction. *See, e.g.*, Black's Law Dictionary 1166 (2d ed. 1910) ("'Transaction' is a broader term than 'contract.' A contract is a transaction, but a transaction is not necessarily a contract"); 2 Bouvier's Law Dictionary (rev. ed. 1897) (ed. F. Rawle) ("The term transaction

is a broader one than contract"); *Farnsworth v. Duffner*, 142 U.S. 43, 48 (1891) (quoting 2 Pomeroy's Equity, which speaks of a "contract or *other transaction*") (emphasis added); *Embrey v. Southern Gas & Electric Corp.*, 63 So.2d 258, 263 (1953) ("[w]hile every contract is a transaction, every transaction is not a contract"). Because the phrase "contract evidencing" can have no meaning if it refers only to "a transaction," it must be seen as referring to the unitary concept of "a transaction involving commerce" contained in § 2.

Of course, that is exactly how this Court treated these words in *Bernhardt* and *Prima Paint*, a point petitioners would prefer to avoid facing. For if petitioners' interpretation of the words "contract evidencing" were adopted, *Bernhardt* would have to be overruled. In *Bernhardt*, all nine Justices agreed that the employment contract of a plant supervisor, made in New York with a New York corporation and performed in Vermont, was not a "contract evidencing a transaction involving commerce," within the meaning of § 2. *See* 350 U.S. at 200-201; *see also id.* at 208 (Frankfurter, J., concurring) (agreeing that "the Act is not here applicable"). Only the "contemplation of the parties" test, or a similarly narrow reading of § 2, can explain the holding of *Bernhardt*.[13]

Petitioners' *amici* candidly acknowledge that, under their approach, *Bernhardt* would have to be overruled. *See* Br. American Arbitration Ass'n at 7-8 n.1. The most petitioners can say is that the result in *Bernhardt* is "somewhat surprising." Pet. Br. at 21 n.12. But when a proposed theory does not fit this

---

[13] Judge Lumbard's explanation of the "contemplation of the parties" test is in harmony with this Court's result in *Bernhardt*. He cautioned:

> The fact that it is necessary for one party to cross state lines in order to fulfill obligations arising out of the contract should not by itself bring the arbitration clause within the reach of the federal statute. The Arbitration Act should apply only when the parties know or have reason to believe that the performance of the contract will require substantial interstate movement.

287 F.2d at 388 (citations omitted).

Court's prior decisions, it is usually the former — not the latter — that must be rejected. *Bernhardt's* construction of § 2, which came much closer in time to the enactment of the FAA than does petitioners' attempt to rewrite the Act 70 years after its passage, is surely entitled to deference.[14]

Petitioners' final effort to dislodge the "contemplation of the parties" test hinges on the claim that it is unduly "subjective." Pet. Br. at 24. In reality, as Judge Lumbard himself articulated the test (*see* pp. 16-17, *supra*), and as one *amicus* has touched upon (*see* So. Poverty Law Ctr. Br. at 7), the test is a largely objective one inquiring into the reasonable expectations of the parties to a contract. More fundamentally, to the extent that the test does address the subjective contemplation of the parties at the time of contracting, it is faithful to the statutory text and to the underlying purpose of the FAA, *see Volt Information Sciences*, 489 U.S. at 478-79 (FAA protects reasonable expectations of parties).

It is hardly "inexplicable" for Congress to have wanted the application of the Act "to depend in every case upon what the parties *subjectively* understood." Pet. Br. at 24 (emphasis in original). The entire structure of contract law is aimed at

---

[14] There can be no claim that *Bernhardt* has been undermined by subsequent cases involving the FAA. This Court's recent cases, such as *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987), and *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), have concerned securities trading, large corporate transactions, and other matters plainly involving interstate commerce under any understanding of the term. None of the Court's recent cases has examined in any detail the key language of § 2: "contract[s] evidencing a transaction involving commerce." The brief references that do exist only support the *Bernhardt* construction of § 2 giving independent content to its "evidencing" language. For example, *Perry v. Thomas*, 482 U.S. 483, 490 (1989), lauded by petitioners for a passing comment about "the pre-emptive effect of the Federal Arbitration act," on contracts to which it is found to apply, with regard to conflicting state law (*see* Pet. Br. at 6, 8, 11, 17), itself recognizes that § 2 only applies to "a contract *evidencing* interstate commerce." *Id.* at 489 (emphasis added). This Court's recognition that the contract *itself* must evidence interstate commerce is contrary to petitioners' theory, *see* Pet. Br. 15, 24, and strongly supports the "contemplation of the parties" test.

effectuating the parties' understandings as to a contract's scope and contents. Consequently, "the FAA's primary purpose [is] ensuring that private agreements to arbitrate are enforced according to their terms. Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit." *Volt Information Sciences*, 489 U.S. at 479.

The "contemplation of the parties" test is also perfectly consistent with Congress' understanding of background Commerce Clause jurisprudence when the Act was passed in 1925. Congress was on notice that, in construing statutes regulating contractual relationships among parties involved in commerce, the courts would look to the contemplation of the parties to determine whether they intended to participate in interstate as opposed to intrastate commerce. Three examples illustrate the point. In 1906 this Court refused to apply the Sherman Act to a contract for the sale of vessels that contemplated the vessels' being transported between two Ohio cities, despite the fact that the vessels sailed briefly outside Ohio on water "over soil belonging to Kentucky." *Cincinnati, Portsmouth, Big Sandy and Pomeroy Packet Co. v. Bay*, 200 U.S. 179, 183 (1906). This Court ruled that the statute did not cover this contract, despite the direct contact with another state, given what the parties had contemplated and what their contract evidenced. This Court noted that "it does not appear on the record that the contract necessarily contemplated commerce between the States" at all, and ruled that "[t]he contract, in what it especially contemplates, is a domestic contract," with the route to be taken "between Ohio ports," and held that "[t]he chief and visible object of its provisions has nothing to do with commerce among the States." *Id.* at 183-84.

In 1923, just two years before Congress enacted the FAA, this Court considered whether the transactions of New York film distributors with a Nebraska motion picture exhibitor constituted interstate commerce even though the distributor's films were delivered to the exhibitor through agencies in Nebraska. In holding that these transactions *were* interstate commerce, this Court was careful to note that "[t]he contracts with these

distributors contemplated and provided for transactions in interstate commerce." *Binderup v. Pathe Exchange, Inc.*, 263 U.S. 291, 312 (1923) (emphasis added). In fact, in language that fits perfectly with Judge Lumbard's "contemplation of the parties" test, this Court began its inquiry into whether the transactions at issue were interstate commerce with the observation that "[t]he film contracts were between residents of different States and contemplated the leasing by one to the other of a commodity manufactured in one State and transported *and to be transported to* and used in another." *Id.* at 309 (emphasis added).

Finally, in 1925, the very year that Congress enacted the FAA, this Court further emphasized the importance of the parties' contemplation with respect to commercial transactions, in holding that the activities of a Missouri corporation in Arkansas were sufficiently *intrastate* so that an Arkansas law fining a foreign corporation for failing to register with the state was not repugnant to the Commerce Clause. As this Court explained, "[f]rom the beginning, transactions local to Arkansas were contemplated." *Kansas City Structural Steel Company v. Arkansas*, 269 U.S. 148, 151 (1925).

It would therefore have been completely natural for Congress to expect that application of the FAA would depend in part on the contemplation of the parties to the contract.

III. SECTION 2's "A TRANSACTION INVOLVING COMMERCE" LANGUAGE PLAINLY REQUIRES A COURT TO DETERMINE WHETHER THE TRANSACTION AT ISSUE IS ACTUALLY PART OF THE "CURRENT" OR "FLOW" OF INTERSTATE COMMERCE

Even if this Court were to decline this opportunity to overrule *Southland*'s ill-advised extension of the FAA to govern proceedings in state court, and even if this Court were to adopt the linguistic absurdity offered by petitioners and thereby reject the "contemplation of the parties" test, affirmance of the judgment below would still be warranted. For there would still remain the issue of what § 2 means when it refers to "a transaction involving commerce."

Petitioners' theory is simple: In enacting the FAA, Congress drew in part on its Commerce Clause powers. Pet. Br. at 11, 13. "[I]t is now accepted" — that is, post-1937 — that these powers extend to "'activities affecting commerce.'" *Id.* at 12 (citation omitted). One of many definitions of "involving" found in a 1992 dictionary is "'[t]o influence or affect.'" Pet. Br. at 14 (citation omitted). Thus, petitioners contend that "the term 'involving commerce' is sufficiently close in meaning to signal the same intent" as "affecting commerce." Pet. Br. at 15 n.6.[15] Petitioners conclude all of the above from an initial assumption that, when Congress exercised its powers over commerce in 1925, "there is no reason to think that [it] . . . left some (undefined) portion of its power unexercised." Pet. Br. at 16. Petitioners also sprinkle their argument with liberal doses of language from past FAA cases describing the broad preemptive effect of the FAA in sweeping aside barriers to arbitration once the Act *is* found to apply to a given contract. *See, e.g., id.* at 6; *compare* note 14, *supra* (observing that petitioners' most-cited case on this point, *Perry v. Thomas*, 482 U.S. 483 (1989), actually reaffirms the "evidencing" requirement of § 2). Petitioners repeatedly suggest that this Court has already held that § 2 extends to all transactions that Congress can constitutionally reach under the Commerce Clause.

What petitioners refuse to confront is that in fact this Court has already construed § 2 as *not* reaching to the limits of the Commerce Clause, a decision that remains good law. As already noted, *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198 (1956), held that a transaction clearly within Congress's power to regulate under the Commerce Clause — a plant supervisor's agreement to relocate to another state in order to perform contractual duties — was nonetheless not "a contract evidencing a transaction involving commerce" under § 2. Thus, this Court has already ruled against the principal argument advanced by petitioners (Pet. Br. at 11-23), that § 2 governs all transactions Congress is constitutionally permitted to regulate. Petitioners

[15] That assumption is fundamentally incorrect. *See* note 16, *infra*.

have not even attempted to make a case for overruling *Bernhardt*. The best they can manage is to describe its unanimous holding as "surprising" and to suggest that the only reason that § 2 was construed narrowly was to avoid an *Erie* problem. Pet. Br. at 21 n.12. But the supposed motivation for the holding in *Bernhardt* is irrelevant. There is no basis for overruling *Bernhardt*, nor do petitioners suggest one. *See* pp. 20-21 & n.14, *supra*.[16]

Setting aside petitioners' untenable theory that § 2 was intended to encompass all transactions within Congress' commerce powers, there is only one remaining way to read § 2: as the words "transaction involving commerce" would have been understood in 1925, when Congress enacted the FAA. It is settled, of course, that the terms of a statute are to be construed according to their meaning at the time of enactment. *E.g., Will v. Michigan Dept. of State Police*, 491 U.S. 58, 69 & n.9 (1989) (engaging in "an examination of authorities of the era" in which

[16] Even if this Court were willing to revisit *Bernhardt* and consider the possibility that Congress, in enacting the FAA in 1925, intended to exercise its Commerce Clause powers to the constitutional limit, petitioners and their *amici* have failed to address the issues that would be pivotal to this inquiry. It is not enough simply to posit, as petitioners do, that "the term 'involving commerce' is sufficiently close in meaning to signal the same intent" as "the term 'affecting commerce,'" Pet. Br. at 15 n.6, or to draw a hurried analogy to the Sherman Act, as one of petitioners' *amici* does. *See* Brief of American Arbitration Association as *Amicus Curiae* at 12-13. As this Court noted in *Federal Trade Comm'n v. Bunte Bros.*, 312 U.S. 349, 351 (1941), where Congress exercises its commerce powers over "activities which in isolation are merely local, it has normally conveyed its purpose explicitly," and "a due regard for a proper adjustment of the local and national interests" requires in such circumstances that statutes not be construed "beyond the obvious meaning of language unless otherwise the purpose of the Act would be defeated." *Id. See also id.* at 355; *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 195-99 (1974); So. Poverty Law Ctr. Br. at 6 n.6. This Court recently employed a similar principle in unanimously rejecting a statutory construction that failed to evince a "clear and manifest congressional purpose" to displace state substantive protections by increasing the scope of mandatory labor arbitration. *See Hawaiian Airlines, Inc. v. Norris*, 62 U.S.L.W. 4537, 4540 (U.S. June 20, 1994).

42 U.S.C. § 1983 was adopted in order to construe the meaning of "person").

By the year the FAA was enacted, this Court had at least twice explicitly compared the concept of a transaction "involving" commerce to the concept of a transaction "affecting" commerce and had drawn a sharp distinction between the two. In *United Mine Workers v. Coronado Coal Co.*, 259 U.S. 344, 407-08 (1922), this Court reaffirmed its position that coal mining and manufacturing did not constitute "interstate commerce," and thus that a coal miners' strike shutting down a local coal mine did not involve "a direct obstruction" of commerce, although it "may affect it by reducing the amount of coal to be carried in that commerce." Addressing the nature of Congress's power over commerce, the Court noted

> a distinction to be drawn in cases which do not *involve interstate commerce intrinsically* but which may or may not be regarded as *affecting* interstate commerce so directly as to be within the federal regulatory power.

Id. at 410 (emphasis added). In 1925 this Court reaffirmed the distinction between transactions that "involve" commerce and thus were clearly within Congress' power, and those that "affect" commerce, and thus were more dubious subjects of regulation. *See United Leather Workers v. Herkert*, 265 U.S. 457, 466-71 (1925). Summarizing its Commerce Clause jurisprudence, the Court confirmed that Congress' power over activities that "involve interstate commerce intrinsically" concerned "the practical conception of interstate commerce as a flowing stream from one State to another formed by a regular course of business." *Id.* at 467.

Given this Court's caselaw circa 1925 concerning the powers Congress had in its possession over commerce, the phrase "a transaction involving commerce" should be defined to mean a transaction between businesspersons who are part of the "flowing stream" of commerce as the term "commerce" was understood in 1925. That interpretation is fully consistent with the relevant legislative history concerning the objectives behind

the Act. *See* note 11, *supra*; So. Poverty Law Ctr. Br. at 4-5 & n.8. There is no basis for concluding that in 1925 Congress was attempting to draw on uncertain powers over undefined transactions that might somehow "affect" commerce. Rather, by its careful choice of language in § 2 Congress was drawing only on its power to regulate transactions that "involve interstate commerce intrinsically," as had been previously defined by this Court.

If § 2 is construed in this manner, then the termite bond to which the Dobsons and the Terminix companies are parties cannot qualify as "a transaction involving commerce." The termite bond was merely a personal contract that insured the Dobsons against the costs of termite damage and extermination, and all services under it were performed locally. *See* pp. 2-6, *supra*. That the transaction included "parties in different states" and "materials brought from one state to another," Pet. Br. at 28, does not mean that it "involv[ed] commerce" within the meaning of § 2.[17]

In the end, petitioners and their *amici* are left to argue that the FAA should not be "frozen" to embody Congress' intention in 1925, but rather "should be interpreted in view of modern, more expansive notions" of Congress' powers. Br. of American Arbitration Ass'n at 13. Petitioners' *amici* go so far as to claim that it would be "wholly arbitrary" to construe the Arbitration Act "on the basis of the particular words that Congress used" rather than on the basis of Congress' supposed intent to extend the FAA to the limits of the Commerce Clause. *Id.* at 12-13.

---

[17] The pertinent caselaw on this subject was well settled by the time the FAA was enacted. *See, e.g., Ware and Leland v. Mobile County*, 209 U.S. 405, 411 (1908) ("contracts between citizens of different States are not the subjects of interstate commerce . . . where the contract itself is to be completed and carried out wholly within the borders of a State, although such contracts incidentally affect interstate trade"); *Hooper v. California*, 155 U.S. 648, 654 (1895) ("personal contracts between parties . . . though the parties may be domiciled in different States . . . are . . . local transactions, and are governed by the local law"). *See also New York Life Ins. Co. v. Deer Lodge County*, 231 U.S. 495, 510 (1913) ("contracts of insurance are not commerce at all, neither state nor interstate").

But, for better or worse, statutes must be read as "freezing" into law the memorialized intentions of the particular legislature that enacted them. They cannot be rewritten 70 years after the fact based on insupportable conjecture about Congress' inchoate and unexpressed intentions.

Petitioners' theory of statutory interpretation might have force where a legislature expressly provides that its enactment goes to the limit of what the Constitution permits, as is the case with some state long-arm statutes, or where the legislative intent to do so is equally clear, as in the case of the Sherman Act.[18] But the language of the FAA — which is confirmed by the relevant legislative history — leaves no doubt that the "involving commerce" test was adopted so that the scope of the FAA would be limited to transactions between merchants, interstate shippers, national or regional companies, and others directly engaged in the "flowing stream" of commerce.

CONCLUSION

The judgment of the Alabama Supreme Court should be affirmed.

Respectfully submitted,

ALLAN R. CHASON
CHASON & CHASON, P.C.
Post Office Box 100
157 Hoyle Avenue
Bay Minette, AL 36507
(205) 937-2191

KENNETH J. CHESEBRO
Counsel of Record
1600 Massachusetts Avenue
Cambridge, MA 02138
(617) 661-4423

[18] *See, e.g., Summit Health, Ltd. v. Pinhas*, 111 S. Ct. 1842, 1846 n.7 (1991) ("[t]he floor debates on the Sherman Act reveal, in Senator Sherman's words, an intent to 'g[o] as far as the Constitution permits Congress to go'") (quoting 20 Cong. Rec. 1167 (1889)).

JONATHAN S. MASSEY
3920 Northampton Street
Washington, D.C. 20036
(202) 686-0457

KENNETH W. HOOKS
PITTMAN, HOOKS, MARSH, DUTTON & HOLLIS, P.C.
1100 Park Place Tower
Birmingham, AL 35203
(205) 322-8880

Counsel for Respondents

July 19, 1994